Michael K. Jeanes, Clerk of Court
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SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

LC2011-000695-001 DT 03/07/2012

COMMISSIONER MYRA HARRIS

CLERK OF THE COURT
K. Waldner
Deputy

RAFAEL SALAKHOV

RAFAEL SALAKHOV
2758 GENUINE RISK ST
PERRIS CA 92571

v.

PARK WESTERN LEASING INC (001)

BRIAN D MYERS

REMAND DESK-LCA-CCC
UNIVERSITY LAKES JUSTICE COURT

RECORD APPEAL RULING / REMAND

Lower Court Case No. CC2010559323RC.

Defendant/Counterclaimant Appellant Park Western Leasing Inc. (Defendant) appeals the University Lakes Justice Court's determination that Plaintiff/Counterdefendant is not liable for reimbursing Defendant for the taxes California imposed against Defendant under the terms of their contract. Defendant contends the trial court erred. For the reasons stated below, the court affirms the trial court's judgment.

I. FACTUAL BACKGROUND.

On October 24, 2005, the parties entered a lease Agreement for Plaintiff to lease a utility reefer trailer from Defendant for 60 months. According to the "Terms" section of the agreement, the lease payment was $1,302.00 per month. No sales tax was listed for the amount of each payment and the total monthly payment was $1,302.00. No use tax or use tax provision or section was included under the "Terms" section. Page 1 of the Agreement specifically incorporated the terms and conditions of the page as well as those of pages 2 through 4. The Agreement included a specific choice of law provision—# 7—which stated:

> CHOICE OF LAW. This lease shall not be effective until signed by Lessor at its principal office in Tempe, Arizona. This Lease shall be considered to have been made in the State of Arizona and shall be interpreted in accordance with the laws and regulations of the State of Arizona. Lessee agrees to jurisdiction in the State of Arizona in any action, suit or proceeding regarding this Lease, and concedes that it, and each of them, transacted business in the State of Arizona by entering into this Lease. In the event of any legal action with regard to this Lease, Lessee agrees that venue may be located in Maricopa County, Arizona.

The Agreement also included a provision about insurance, liens and taxes. Provision 16 stated the following:

> Lessee shall pay all charges and taxes (local, state and federal) which may now or hereafter be imposed upon the ownership, leasing, rental, sale, purchase, possession, or use of the Equipment, excluding however, all taxes on or measured by Lessor's net income. If Lessee fails to pay said charges or taxes, Lessor shall have the right, but shall not be obligated, to pay such charges or taxes. In that event, Lessor shall notify Lessee of such payment and Lessee shall repay to Lessor the cost thereof within 15 days after such notice is mailed to Lessee.

In addition, the Agreement included an indemnity provision—#17—mandating that Lessee indemnify Lessor for claims, actions, damages, or liabilities, including all attorney fees "arising from or connected with" the equipment. This provision was "without limitation." Plaintiff initialed and/or signed all four pages of the Agreement.

Plaintiff signed the lease Agreement on October 24, 2005. Two days later, on October 26, 2005, Plaintiff (1) executed a collateral agreement pledging a 1999 Freightliner semi-truck as collateral for the lease; and (2) executed a personal guaranty—the Sales/Use Tax Indemnification—for the amounts owed under the Agreement.

Defendant purchased the equipment in California prior to leasing the equipment to Plaintiff but failed to pay the required California sales/transaction tax. In 2008, Defendant was audited by the California Board of Equalization and assessed $6,029.45 for the past due taxes, interest, and penalties. After paying the tax, Defendant sought reimbursement from Plaintiff. Plaintiff (1) denied owing the reimbursement under the Agreement; (2) asserted it was a lessee and (3) maintained the tax did not relate to the lease Agreement. Plaintiff relied on the California revenue and tax code provisions related to the lease of mobile transportation equipment which says trucks are classified as mobile transportation equipment. Plaintiff also asserted another California Tax Code Provision—Regulation 1661 Lease of Mobile Transportation Equipment (b)(1)—as its authority releasing him from liability. This provision states:

> With respect to leases of mobile transportation equipment, the sale to the lessor is the retail sale and the lessor is the consumer of the equipment. Accordingly, either sale of the equipment to the lessor or its use in this state may be subject to tax. For example, if a dealer of that mobile transportation equipment makes the sale and delivery within California, the transaction is subject to sales tax unless the lessor makes a timely election to report his or her tax liability measured by the fair rental value as provided in subdivision (b)(2).

Because Defendant held the title to Plaintiff's truck and trailer, Plaintiff sued. In his Complaint—filed December 6, 2010,—Plaintiff alleged he was strictly an interstate operator and Defendant was "supposed to submit necessary paperwork to the State of California in order to

get my trailer exempt for the use and sale [sic] tax." Defendant counterclaimed and alleged Plaintiff was responsible for any sales or use taxes. Defendant asserted (1) the lease Agreement and (2) the Sales/Use Tax Indemnification Agreement indicate Plaintiff's ultimate responsibility for the taxes. In addition, Defendant requested attorney fees pursuant to the parties' agreements.

The trial court held a trial on March 30, 2011. Plaintiff—through his witness—relied on the California tax code and argued his lump sum monthly payment included a sum that was to be used to reimburse Defendant for the taxes.[1] Defendant argued the tax indemnification agreement was controlling[2] and specifically described the sales and/or use tax. The trial court asked Defendant to restate its position.[3] Defense counsel stated Exhibit 1—the lease Agreement—included (1) a general indemnity clause—clause 17[4]—and (2) section 24 which has language about legal actions.[5] The trial court reviewed the Agreement and summarized Defendant's position as saying the $1,302 monthly payment did not include the required sales tax.[6]

Defense counsel also referred to the 2nd paragraph of the Sales/Use Tax indemnification Agreement.[7] Plaintiff objected to the use of the document and claimed the document was incomplete because it was missing an invoice number.[8] Defense counsel responded the lease was not incomplete because (1) it referred to a lease number; and (2) included Plaintiff's name as lessee.[9] Defense counsel argued the language of the contract was plain and unambiguous.[10] The relevant language of this Agreement is:

> In consideration of your doing so, the undersigned Lessee does hereby agree to indemnify you against and save you harmless of and from any assessment, charge, or claim by any governmental agency for any sales and/or use tax in connection with or arising by virtue of said lease.

Plaintiff read—over Defense counsel's objection—the definition of "fair rental value" from the California Tax Code[11] Defense counsel then referred to the additional collateral agreement and asked that Defendant be awarded the truck referred to in the agreement.[12]

The trial court took the matter under advisement. Thereafter, the trial court determined Plaintiff did not owe Defendant reimbursement for the $6,029.45 taxes, interest, and penalties

[1] Audio recording, bench trial, March 30, 2011 at 2:59:55 –3:00:23.
[2] *Id*. at 3:01:37–3:01:53.
[3] *Id*. at 3:03:28.
[4] *Id*. at 3:03:41.
[5] *Id*. at 3:04:24–3:04:52.
[6] *Id*. at 3:05:11–3:05:32.
[7] *Id*. at 2:05:39–3:06:12.
[8] *Id*. at 3:06:47–3:06:59; 3:07:27–3:08:32.
[9] *Id*. at 3:07:03–3:07:25.
[10] *Id*. at 3:09:01.
[11] *Id*. at 3:10:36–56.
[12] *Id*. at 3:13:41–3:14:02.

and dismissed Defendant's counterclaim. The trial court ruled—in its Judgment—Defendant must pay Plaintiff's court costs and ordered Defendant to release the title to Plaintiff's truck and trailer. In ruling on the issue, the trial court specifically found (1) there was no written obligation for Plaintiff to pay any use tax under the "terms" section of the lease and (2) the special payment information was blank. The trial court found an ambiguity between the language of "0.00 Sales Tax term" and provision 16, and construed the agreement against Defendant as the drafter of the lease. In determining Plaintiff had no responsibility for reimbursing Defendant for the use tax Defendant paid to the State of California, the trial court also considered Defendant's Exhibit 5 to its Trial Memorandum which stated: "The purchase price of the trailer is subject to sales/use tax because the Lessor did not report measure of tax based on Fair Rental Rental [sic] Value."

Defendant filed a timely appeal. This Court has jurisdiction pursuant to ARIZONA CONSTITUTION Art. 6, § 16, and A.R.S. § 12–124(A).

II. ISSUES:

A. Did The Trial Court Err In Determining Plaintiff Had No Obligation To Reimburse Defendant Under the Lease Agreement.

Defendant asserts the trial court erred and appeals from the trial court's judgment finding Defendant responsible for the use tax and awarding Plaintiff his court costs. In so doing, Defendant maintains (1) the contract between the parties is plain and unambiguous and (2) Plaintiff is obligated—by contract—to indemnify Defendant for the use tax payment.

This action pits the language of the lease "Terms" of $1,302 per month with no sales tax included against the language in provision 16 re: "pay all charges and taxes (local, state and federal) which may now or hereafter be imposed upon the ownership, leasing, rental, sale, purchase, possession, or use of the Equipment." Defendant argues the language of provision 16 controls and imposes a duty on Plaintiff to pay the sales/use tax of $6,029.45 imposed in 2008 for the sale/lease of the vehicle in 2005. Plaintiff disagrees and argues (1) the "Terms" provision conflicts with provision 16; and (2) the California Tax Code relieves Plaintiff of any responsibility.

Contract interpretation is a question of law. As such contract interpretation issues are reviewed *de novo*. *Grosvenor Holdings, L.C. v. Figueroa*, 222 Ariz. 588, 218 P.3d 1045 ¶¶ 8–9 (Ct. App. 2009); *Bennett v. Baxter Group, Inc*. 223 Ariz. 414, 224 P.3d 230 ¶ 12 (Ct. App. 2010). In reviewing the contract, this Court will construe the contract as a whole *Bennett v. Baxter, id*, at ¶ 15 to determine if (1) the contract is plain and unambiguous; or if (2) the contract is subject to contradictory interpretation.

The "Terms" provision of the contract obligates Plaintiff to pay $1,302.00 per month. Payment for sales tax is listed as 0.00 and the total monthly payment Plaintiff agreed to pay is $1,302.00. This sum is again listed under the "Advance Rental Payment" portion of the terms. It is clear from the face of this page that Plaintiff knew he was supposed to pay $1,302.00 per

month. The evidence before the trial court established Plaintiff knew the amount to be paid and paid this amount every month. There is no heading or itemization or indication of any obligation to pay any use tax under the "Terms" section.

In contrast, Provision 16—which is incorporated into the contract—deals with insurance, liens and taxes. The insurance portion of this provision obligates lessee (Plaintiff) to purchase insurance and specifically provides that if lessee (Plaintiff) fails to do so, Defendant (lessor) may—but is not required to—provide insurance and assess Plaintiff lessee for the cost of the insurance. This provision also informs lessee (Plaintiff) he must keep the equipment free from all liens. In addition, this provision states the lessee shall pay all charges and taxes "which may now or hereafter be imposed upon the ownership, leasing, rental, sale purchase, possession, or use of the Equipment." The use tax is one that was imposed "hereafter" on the use of the Equipment. This provision also includes language providing that if the lessee (Plaintiff) fails to pay the taxes, the lessor has the right to pay the taxes, notify lessee, and be repaid the amount. In this case, however, there is no information indicating the lessee failed to pay taxes or was notified about any tax liability. Instead, after three years, the California Board of Equalization notified lessor (Defendant) of Defendant's obligation to have paid taxes three years earlier and assessed Defendant with the past due taxes, interest, and penalties.

Provision 16 requires Plaintiff to pay taxes imposed upon the ownership, leasing, rental, sale, purchase, possession or use of the Equipment that were due "now" or were to be "hereafter" imposed. Many of these elements do not apply as there is no ownership, sale, or purchase. The only potential areas for Plaintiff's liability are for the leasing, rental, possession, or use of the equipment. According to the language of provision 16, the requirement to pay these potential taxes could be imposed but had not yet been imposed.

Although Defendant asserts the contract is clear and unambiguous, this Court does not find the provisions regarding the taxes to be so. Plaintiff was given a specific monthly amount for the lease and no sales or use taxes were included. If Defendant wished to include a sum for use taxes, Defendant could have done so and made it apparent under the "Terms" provision listing the monthly amount. Instead, Defendant provided a separate provision causing Plaintiff to be responsible for an unnamed sum but not even providing Plaintiff with the opportunity to be notified about the requested amount. There is no evidence reflecting Plaintiff was specifically informed about either the possibility or the need to pay a use tax. Similarly, there is no evidence that Plaintiff was involved in any discussions about the past due use tax, interest, and penalties before or when Defendant incurred this debt. Instead, Defendant allowed Plaintiff to think his total obligation was only the $1,302.00 monthly obligation listed on the first page of the document. Because these two provisions apparently conflict, the trial court could resolve the issue by construing the contract against Defendant. When the language of a contract is ambiguous, the court may construe the language against the drafter of the contract. *United California Bank v. Prudential Ins. Co. of America*, 140 Ariz. 238, 258 681 P.2d 390, 410 (Ct. App. 1984).

B. Did the Sales/Use Tax Indemnification Guaranty Obligate Plaintiff To Pay The Use Taxes.

Plaintiff signed a secondary guaranty—the Sales/Use Tax Indemnification Guaranty—obligating him to pay the taxes owed "under the Lease and the Agreement".[13] However, if the taxes owed were not "under" or as a result of the Agreement, Plaintiff would have no need to reimburse Defendant. The specific language of the Guaranty governs. The Agreement states:

> In consideration of your doing so, the undersigned Lessee does hereby agree to indemnify you against and save you harmless of and from any assessment, charge, or claim by any governmental agency for any sales and/or use tax in connection with or arising by virtue of said lease.

Here, the tax obligation may have been incurred prior to the Lease and not necessarily "in connection with or arising by virtue of" the lease. Because this matter involves interpretations of the California Tax Code, it is instructive to look at case law from California as guidance.[14] The underlying rationale for the sales tax/use tax provisions is to provide tax equality. In *Burroughs Corp. v. State Bd. Of Equalization*, 153 Cal. App.3d 1152, 1159, 200 Cal, Rptr, 816, 820 (Ct. App. 1984) the California Court of Appeals said:

> The purpose of the use tax is to place local retailers upon an equal footing with their out of state competitors, since these competitors are not liable for the California sales tax. It has been said that all property not actually covered by the sales tax is subject to the use tax.

When a qualifying event occurs in California, either sales or use tax must be paid to the State of California. Leasing of property is a qualifying event. In *Union Oil Co. of Cal. v. State Bd. Of Equalization*, 60 Cal.2d 441, 447, 386 P.2d 496, 500. (1963) the California Supreme Court held the owner of the property is responsible for the use tax when the owner first leases the property. The Court ruled:

> [T]he statutory definition of 'use' includes the owner's use of the property by means of leasing it, and that, further, such an interpretation accords with the statutory design that the use and sales taxes be interpreted as complementary taxes.

The Court continued, gave an expansive definition of the term "use," and said the statutory definition of "use" includes leasing the property. The California Supreme Court quoted with approval the language from Keesling, *Conflicting Conceptions of Ownership in Taxation*, 44 Cal. L. Rev. 866, 867 (1956) and said:

[13] Defendant/Counterclaimant's Trial Memorandum at p. 5, ll. 12–13.

[14] Although the contracts were executed in Arizona and subject to Arizona law, this Court will look to California courts for guidance in interpreting California tax issues. This Court recognizes that California law is persuasive but not binding on the Court.

> [W]hen a person buys property in one state for the purpose of leasing it and transporting it to a person in another state where a use tax law is in effect, the lessor is considered as using the property in the second state for the production of income and hence is subject to such state's use tax even though he personally makes no physical use of the property in such state.

Union Oil Co. of Cal. v. State Bd. Of Equalization, 60 Cal.2d at 450, 386 P.2d 496 at 502. In the current case, Defendant is the lessor in Arizona who leased the utility reefer trailer to Plaintiff for use in California. The act of leasing the utility reefer trailer subjected Defendant to California's use tax even though Defendant did not use the trailer himself. Thus, Defendant became the responsible party and was obligated to pay California's use tax in exchange for the privilege of leasing Defendant's vehicle.

In *Atchison, Topeka & Santa Fe Ry. Co. v. State Board of Equalization*, 139 Cal. App.2d 411, 417, 294 P.2d 181, 85 (Ct. App. 1956) the District Court of Appeals, First District, Division 1 of California referred to a taxable moment or taxable event. In *Action Trailer Sales, Inc. v. State Bd. Of Equalization*, 54 Cal. App.3d 125, 126 Cal. Rptr. 339 (Ct. App. 1975), the California Court of Appeals specifically ruled about the type of tax required of a lessor of mobile office trailers. The Court said the lessor may elect to either (1) pay a sales tax measured at the time of purchase; (2) pay a use tax measured by the purchase price at the time when the property is first placed in rental service; (3) pay a use tax collected from the lessee; or (4) pay the amount of use tax the lessor should have collected from the lessee. This determination was later changed as a result of a change in the California Tax Code and the amending of § 6006(g)(4) which excluded the leasing of mobile transportation equipment[15] from the definition of sale. Later, in *Newco Leasing Inc. v. State Bd. Of Equalization*, 143 Cal. App. 3d 120, 123, 191 Cal Rptr. 588, 589–90 (Ct. App. 1983), the Court of Appeal, Second District, Division 2, held:

> The purchase of such equipment by an individual or business entity engaged in the business of leasing the equipment to the public is taxed as a retail sale but the subsequent leasing of the equipment is exempt from further taxation.

These decisions indicate (1) the taxable moment for Defendant occurred at the time the utility reefer trailer was purchased and (2) the obligation to pay these taxes belonged to Defendant.

In the current case, Defendant (lessor) did not pay California either a sales tax measured at the time of purchase or a use tax measured by the purchase price when the utility reefer trailer was purchased or first placed in service. Ultimately, Defendant paid the use tax. While Defendant lessor could have specifically contracted for Plaintiff to later reimburse this amount, Defendant did not do so. According to the amended statute, the Defendant lessor was the business entity engaged in the business of leasing the equipment to the public. As such, Defendant was liable for the tax which was to be assessed as a retail sale. This was an obligation that was owed to the

[15] Trucks are included in the definition of mobile transportation equipment.

State of California by the Defendant lessor for the privilege of leasing a truck to be used in California. The subsequent leasing of the truck was exempt from further taxation. Because the California tax code specifically exempted the lessee from any tax obligation, and because the obligation to pay the use tax occurred before the Sales/Use Tax Indemnification Guaranty took effect, Plaintiff had no requirement to pay this tax.

Defendant argued that the California Tax Code and its interpretations are inapposite because the Lease Agreement—provision 7—subjects the parties to (1) interpretations in accordance with the laws and regulations of the State of Arizona; and (2) to Arizona's jurisdiction. Choosing Arizona law includes utilizing Arizona's conflicts of law provisions. In Arizona, courts will apply the law of the state chosen by the parties provided the law has some nexus to the contract or the parties. *Winsor v. Glasswerks PHX, L.L.C*., 204 Ariz. 303, 63 P.3d 1040 ¶ 9 (Ct. App. 2003). However, Arizona courts also follow the Restatement (Second) of Conflict of Laws in determining choice of law issues. While substantive matters are generally governed by the law of the jurisdiction chosen in the choice of law provisions, *Cardon v. Cotton Lane Holdings, Inc*. 173 Ariz. 203, 206, 841 P.2d 198, 201 (1992), this is not an unfettered right. In *Swanson v. Image Bank, Inc*. 206 Ariz. 264, 77 P.3d 439 ¶ 8 (Ct. App. 2003) the Court of Appeals said:

> However, neither a statute nor a rule of law permitting parties to choose the applicable law confers unfettered freedom to contract at will on this point.

The *Swanson, id.*, court then quoted from comment g to the Restatement (Second) of Conflicts § 187 that fulfillment of the parties' expectations is not the only value and the court must give due regard to state interests and state regulations. Here, the parties specifically agreed to use Arizona law. However, nothing in the choice of law provision prohibited the trial court—or this Court—from considering California's interpretations of its own tax code. Consideration of California's interpretation of its tax code provides some balance between the interests of the states and the expectations of the parties.

Arizona—like California—imposes use taxes. Similarly, like California, Arizona's sales and use taxes are complementary and are "intended to reach all applicable transactions, either by imposing a sales tax on the seller or a use tax on the purchaser." *Arizona Dept. of Revenue v. Care Computer Systems, Inc*. 197 Ariz. 414, 4 P.3d 469 ¶ 22 (Ct. App. 2000). In addition, Arizona law provides that an administrative agency must follow its own rules and regulations. *Arizona Dept. of Revenue v. Care Computer Systems, Inc. id*., at ¶ 18. Because Arizona recognizes the importance of following administrative regulations, the trial court did not err by considering the California Tax Code regulations concerning sales and use taxes of mobile transportation equipment.[16]

[16] Additionally, the trial court did not premise its judgment on its consideration of the California Tax Code regulations. Instead, the trial court apparently relied on the four corners of the document in determining the appropriate party to be responsible for the use taxes.

The Sales/Use Tax Indemnification Guaranty affects "sales and/or use tax in connection with or arising by virtue of said lease." Because the "arising by" or "in connection with" language is limiting, this Court must also determine if the obligation to pay the use tax was one "arising by" or "in connection with" the lease. Neither party produced any case law or interpretation to aid in making this determination. This Court found no controlling authority.

This Court notes the terms "arising by" and "in connection with" are indefinite. The words do not have precise legal meanings. The question then is if the terms in the Sales/Use Tax Indemnification Guaranty can be construed to mean only obligations which occur after the lease is in place or if the term means anything that can be related to the lease, even if the activity or obligation occurred (1) prior to or (2) at the instant of the signing of the agreement. Because these terms seem to have some elasticity of meaning, this Court finds the terms are ambiguous. Because the terms are ambiguous, this Court further finds the trial court did not err in construing the term against the Defendant who prepared the contract.

After (1) looking at the contract as a whole; and (2) because the Sales/Use Tax Indemnification Guaranty was signed after the Lease Agreement was already in place, this Court finds the Sales/Use Tax Indemnification Guaranty obligated Plaintiff to pay only those taxes that accrued after the lease was in effect and could be directly attributed to Plaintiff's actions. Because the use tax is a complementary tax assessed against the lessor (Defendant) for leasing the truck and because this Court determines the use tax accrued no later than the signing of the Lease Agreement, this Court finds the use tax obligation did not "arise by" and was not "in connection with" the lease. Therefore, Plaintiff was not obligated to reimburse Defendant. Additionally, because the California Tax Code exempts Plaintiff from paying taxes and because no Agreement specifically imposed a tax on Plaintiff, this Court concurs with the trial court's contract interpretation.

III. CONCLUSION.

Based on the foregoing, this Court concludes the University Lakes Justice Court did not err in determining Defendant was responsible for the use tax.

IT IS THEREFORE ORDERED affirming the judgment of the University Lakes Justice Court.

IT IS FURTHER ORDERED remanding this matter to the University Lakes Justice Court for all further appropriate proceedings.

IT IS FURTHER ORDERED signing this minute entry as a formal Order of the Court.

/s/ Myra Harris
THE HON. MYRA HARRIS
Judicial Officer of the Superior Court

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